

Real estate statistics point to precarious state of Chinese economy

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China's property sector faces a sharp downturn that could drag the rest of the economy down with it. While official figures show construction activity nationally increased marginally in 2015, there are signs of oversupply, lack of profitability and unsustainable credit growth. For the past seven years, speculative investment in real estate has been a prop that maintained growth in China, but this has laid the foundation for a broader crisis.

The possibility of a collapse was openly stated this week by Zhou Xiaochuan, the governor of the People's Bank of China (PBOC), the country's central bank. In an interview with *Caixin Weekly*, he said: "[W]e've learned lessons from the global financial crisis, which started from the 2008 subprime crisis in the US, that the cross-contagion between the real estate market, the subprime market and shadow banking system in the US produced disastrous impacts. There is also the soil for such contagion in China."

A report released by Standard Chartered in November 2015 estimated that half of the economic slowdown in China since 2010 was due to a "slump in house-building" after "taking into account linkages with related sectors." These "linkages" included the manufacturers of cement, steel, glass and other building products, all of which face a crisis of overcapacity and falling profitability. The report estimated housing starts to have fallen 28 percent in the past two years.

Figures released by the Chinese National Bureau of Statistics (NBS) show that for 2015 overall nominal investment in real estate development rose by just 1.0 percent from a year earlier to 9.598 trillion yuan (\$US1.46 trillion). Of this total, 67.3 percent was for residential real estate, up by 0.4 percent on 2014.

Across the country, however, there were significant disparities. Investment in the three north-eastern "rust

bucket" provinces dropped by 28.8 percent. In the main eastern provinces, which account for more than half the total, investment was up 4.5 percent. In the central provinces it was up by 4.2 percent, but in the western provinces it was down by 0.8 percent.

According to the latest PBOC figures on real estate loans for 2015, reported last week by the Xinhua news agency, individual loans grew by 23.9 percent to 13.1 trillion yuan, with outstanding real estate loans accounting for 22.4 percent of the total. This growth was driven by five cuts to official interest rates. However these figures are likely to understate the real situation.

A McKinsey report in 2015 estimated that half of China's non-financial sector debt—\$9 trillion—was tied to property either directly or in loans to firms making building materials. A report last week in the *New York Times* estimated that by the end of 2016 total loans and other credit in China would be \$30 trillion, up from \$9 trillion only seven years ago, and that by that time up to 22 percent of these would be "non-performing," i.e., either behind on repayments or unlikely to pay.

China faces a massive oversupply of property, especially residential property. This is now producing a contraction in construction. The NBS figures show that "the floor space of residential buildings started in the year amounted to 1.06 billion square meters, down by 14.6 percent." The International Monetary Fund (IMF) estimates that China still has over a billion square metres in unsold property. Thus even the current construction levels are unsustainable.

The problem over oversupply is, for now, concentrated in Tier 3 and Tier 4 cities—those with populations smaller than five million residents. According to Wang Jianlin, chairman of property and entertainment conglomerate Dalian Wanda Group, it

could take four to five years for the market to digest the inventory in these cities.

This is a direct result of massive speculation in property, resting on cheap credit supplied by the government in response to the 2008 global financial crisis. The Standard Chartered report from November estimated excess inventory in 2014 at 9 million homes, with another 40-50 million “sold but being held vacant as investments.”

The central government’s response is becoming more desperate. In 2015, it made clearing the inventory of unsold and unused housing a priority for 2016. A number of plans were outlined, such as the accelerated urbanisation of up to 270 million migrant workers (equal to around 80 percent of the population of the United States). They were to be shifted from the countryside into the cities, including by granting them residency permits, allowing them to buy homes in the cities where they work. At present rural migrant workers are treated as second class citizens with few rights and social benefits. Other measures included a reduction in the deposit required for a first home from 25 percent to 20 percent, and on second homes from 60 percent to 40 percent.

Provincial and local governments have announced subsidies and incentives to attract buyers. Puyang, in Henan province, introduced a 150-yuan per square metre subsidy to rural residents who purchased homes in towns and cities. In Anyang last August, the government started to provide a 20,000 yuan subsidy for anyone willing to buy an apartment in the city.

The consequences of an implosion in the property market could be severe for the Chinese economy as a whole. Tao Dong, a Credit Suisse economist, said in January: “China’s property market was the biggest growth engine for its economy in the past decade ... It is largely over now, and for China, there is no alternative.”

Credit Suisse recently warned: “The key catalysts for a hard landing in China would be a fall in property prices of greater than 15 percent, China’s loan-to-deposit ratio rising above 100 percent or capital flight accelerating, leading to a devaluation of the yuan.”

Overall residential construction investment in China peaked in 2013 at 10.4 percent of gross domestic product (GDP), according to the IMF. This figure was only behind Spain, which peaked at 12.5 percent of

GDP in 2006 , and much higher than the US, where residential construction peaked at 6.5 percent of GDP in 2006, before the crash.

After adding the office and retail sectors, all real estate investment accounts for almost 15 percent of China’s GDP. The US and Spanish implosions could be replayed, on a larger scale, in China. This would have devastating consequences, not just for the Chinese economy but for the 60 million workers—15 percent of the urban workforce—directly employed in the property sector.

In his interview, PBOC governor Zhou said the problems could be dealt with via reforms, which “should pick good windows of opportunities.” This would involve “art in timing, cooperation and skills of execution.” China, he said, could learn from international experience “that caution should be exercised to avoid ‘transition trap’ and ‘reform fatigue.’” Such reassurances should be read beside similar statements produced by the US Federal Reserve in the lead-up to the 2008 financial crisis. Then too, the possibility of crisis was denied and clever policy settings were touted as ensuring continued growth.



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